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**DEPARTMENT OF STATE REVENUE**

**LETTER OF FINDINGS NUMBER: 02-0019 & 02-0122**
**Adjusted Gross Income Tax**
**For Tax Year 1997**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

## ISSUE

### I. Adjusted Gross Income Tax—Unitary (Combined) Filing Status

**Authority:**

*Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354, 102 S.Ct. 3128 (1982); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992); *Container Corp. V. Franchise Tax Board*, 463 U.S. 159, 103 S.Ct. 2933
35 ILCS 5/1501(a)(27) and Tenn.Code Ann. § 67-4-2004(25)(B)

Taxpayers protest the auditor's determination that because the parent corporation's ownership of its subsidiary was less than 80%, the subsidiary should not have been included in the combined tax returns with the parent corporation.

### II. Adjusted Gross Income Tax — Throwback Sales

**Authority:** IC 6-3-2-2
45 IAC 3.1-1-64
Indiana Dept. of State Revenue Information Bulletin #12

Taxpayers protest the inclusion of sales to Illinois in the Indiana apportionment sales factor.

## STATEMENT OF FACTS

The taxpayers in the instant case are a parent corporation and its subsidiary. The two entities chose to file a joint-protest. Within this Letter of Findings, the entities will be addressed separately as "Parent" and "Subsidiary" and together as "taxpayers".

### Subsidiary

Subsidiary is a manufacturer and marketer of specialty engineered products used primarily in the automotive after-market industry. Subsidiary is an out-of-state company but conducts virtually all of its business operations from its Indiana location. At the time of the audit, Subsidiary filed combined tax returns with its parent corporation (hereinafter referred to as "Subsidiary's parent"), Parent, and other affiliates. At the time of the audit, Subsidiary's parent owned (55%) of Subsidiary.

Pursuant to the audit, the auditor determined that because Subsidiary's parent's ownership of Subsidiary was less than 80%, Subsidiary should not have been included in the combined tax returns with Parent. Based upon this finding, the auditor recomputed Subsidiary's taxable gross income on a separate basis.

### Parent

Parent is a global manufacturer of energy absorption and power transmission products as well as custom engineered components. At the time of the audit, the Parent's business group was comprised of Parent and seven wholly-owned subsidiaries (an eighth was added in tax year ending December 31, 1997). Parent operates primarily as a strategic management company for its subsidiaries.

Since 1987, Parent has filed on a consolidated basis for gross income tax purposes, and on a combined basis for adjusted gross income tax purposes. All of the companies included in the returns were 100% owned, either directly or indirectly, by Parent, with the exception of Subsidiary. During the audit period, Subsidiary was 55% owned by Subsidiary's parent. (Subsidiary's parent is a subsidiary of Parent.)

Based upon the auditor's belief that there must be 80% ownership for an entity to be included in a combined filing, the auditor excluded Subsidiary from the combined filing for adjusted gross income tax purposes. For the same reason, the auditor also excluded Subsidiary from the consolidated filing, for gross income tax purposes.

## I. Adjusted Gross Income Tax—Unitary (Combined) Filing Status

## DISCUSSION

Taxpayers protest the auditor's determination that Subsidiary should be excluded from the combined filing returns with Parent because Subsidiary was only 55% owned by Subsidiary's parent. The determination was made based upon the auditor's belief that there must be 80% ownership for an entity to be included in a combined filing.

The Supreme Court over the years has developed a three-part test in determining whether a unitary relationship exists: common ownership, common management, and common use or operation. *See, e.g., Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354, 102 S.Ct. 3128 (1982); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992). The first item to be considered under this three-part test is common ownership. As a general rule, *at least* fifty percent (50%) of a corporation's stock must be commonly owned (either directly or indirectly) in order for a corporation to be considered part of a unitary business. *See, i.e.,* 35 ILCS 5/1501(a)(27) and Tenn.Code Ann. § 67-4-2004(25)(B).

The information and documentation available shows that during the audit period Parent (*i.e.*, Parent through Subsidiary's parent) owned fifty-five percent (55%) of the stock of Subsidiary. The evidence of file is sufficient to establish common ownership.

There is also sufficient evidence to find common management and common use or operation. Common management is shown when the parent corporation provides a management role that is grounded in the parent's own operation expertise and overall operational strategy. *See, e.g., Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983). Evidence of a common operation exists where certain functions are performed for the group by the parent (such as purchasing, financing, advertising, marketing, research, tax compliance, insurance, and pension plan management) which independent companies would perform for themselves.

The evidence on file shows that Parent operated as a management company for its subsidiaries and exercised control and influence over them. Officers and directors of Parent held officer positions and directorships within the subsidiaries (*e.g.*, Parent's president also served as the director of Subsidiary). Parent was responsible for the strategic management of the subsidiaries, including the overall approval of the subsidiaries' budgets, and final authority over funding and financing decisions. Furthermore, many of the administrative, management, and financing functions for the subsidiaries were centralized. For example, income tax filing services, legal support, human resources and insurance coverage for each of the subsidiaries was centralized at the level of Parent. Parent also secured third party financing, and provided pension plans, post-retirement, self-insured health care and life insurance benefits for the active and retired employees of the subsidiaries.

On the basis of the facts, it appears that Parent and Subsidiary enjoyed a unitary relationship. Subsidiary should not have been excluded from the combined filing returns with Parent.

## FINDING

Taxpayers' protest is sustained.

## II. Adjusted Gross Income Tax — Throwback Sales

## DISCUSSION

Subsidiary argues that the auditor erred in including its sales to Illinois in the combined filing Indiana sales factor. According to Subsidiary, because it is subject to income tax in Illinois and was included in a combined Illinois income tax return with Parent, Subsidiary's Illinois sales should have been excluded from the numerator of the Indiana sales factor.

Sales made by Indiana corporations to out-of-state purchasers must be apportioned, as income, to Indiana, if the state in which the purchaser resides is without legal authority to claim such income as its own. *See* IC 6-3-2-2(e) and 45 IAC 3.1-1-64. Specifically, if interstate sales are "taxable in another state" - *i.e.*, the state of the purchaser - the sales are not includible in the numerator of the Indiana sales factor. Such sales are defined as throwback sales.

According to IC 6-3-2-2(n):

> For purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if:
>
> (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or
>
> (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

Indiana's regulatory language further defines "taxable in another state." 45 IAC 3.1-1-64 states in part: "A corporation is 'taxable in another state' under the Act when such state has jurisdiction to subject it [the corporation] to a net income tax."

It is well-settled that the basic premise in filing a combined return is that all activities carried on by separate entities are part of a single unitary business (*i.e.*, one taxpayer). *See Indiana Dept. of State Revenue Information Bulletin #12*, page 11. Under the "Finnigan" concept (set forth in *Appeal of Finnigan Corporation*, Cal. St. Board of Equal., Jan. 24, 1990 (88-SBE-022A ) and adopted by the Department in *Indiana Dept. of State Revenue Information Bulletin #12*), a

"taxpayer" for combined filing purposes is defined to mean all corporations (*i.e.*, members) of a unitary group. *See Indiana Dept. of State Revenue Information Bulletin #12*, page 11.

In the instant case, the evidence of file establishes that Subsidiary is part of a unitary group that filed a combined Illinois corporation income tax return for the tax year in question. A review of the Illinois tax return evinces that Subsidiary was not the only entity within the unitary group with activities in Illinois. Another member of the unitary group reported property, payroll, and sales from activities within Illinois. Because this entity was clearly taxable in Illinois, and because Subsidiary and the entity were both members of the Indiana and Illinois unitary groups, and because for purposes of determining throwback or a sales factor calculation the meaning of the term "taxpayer" includes all members of the unitary group, the throwback of Subsidiary's Illinois sales was improper.

## FINDING

Taxpayers' protest is sustained.

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